

GALLAGHER

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OPEN MEETING AGENDA ITEM  
June 2, 2009

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Arizona Corporation Commission  
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**HAND DELIVERED**

Commissioner Paul Newman  
Arizona Corporation Commission  
1200 W. Washington St.  
Phoenix, AZ 85007

Re: *Additional Information Concerning Mercury Control Issues*

Dear Paul:

As we discussed at last week's Open Meeting, here's additional information on the current status of federal and state mercury control standards, as well as AEPCO's current plans on the subject. As background, AEPCO owns and operates the Apache Generating Station near Cochise in southeast Arizona. Two of the units at Apache are coal-fired electric utility steam generating units ("EUSGUs").

When I discussed this matter with AEPCO after the Open Meeting, I learned that there is no federal mercury standard currently in effect. In 2005, the Environmental Protection Agency had passed a Clean Air Mercury Rule ("CAMR") on emissions from EUSGUs. On February 8, 2008, however, the United States Court of Appeals for the District of Columbia vacated the federal CAMR. Although, as you indicated, this is a priority for the new administration, there seems a general consensus that it will take possibly four to five years for the EPA to complete the processes necessary to promulgate a new federal standard.

At the state level, in early 2007, the ADEQ had incorporated the federal CAMR and its monitoring standards into the Arizona Mercury Rule. Obviously, when the federal court overturned the federal CAMR last year, that created significant uncertainty for both ADEQ and Arizona utilities as to whether utilities with EUSGUs needed to comply with the state rule and whether a new federal rule, once adopted, likely would be inconsistent with the current state rule. It also created other monitoring and emissions reporting issues under the state rule for both the ADEQ and utilities because the EPA stopped work on those technical issues when the federal court overturned its rule.

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Given all of this, AEPCO and other members of the Arizona Utility Group have reached agreements with ADEQ on alternative plans for achieving compliance with the State Mercury Standard by December 31, 2016. In AEPCO's case, it currently plans to use the "bromide spray" method which we talked about at the Open Meeting. It will submit that recommendation and supporting data to ADEQ for its review by June 30. Implementation, however, is not required to be commenced until January 1, 2011.

You asked about a comparison between the costs associated with the bromide coal treatment and the estimated \$46 million cost of bag house construction at the Apache Station EUSGUs. AEPCO has not performed a detailed cost comparison between the two. But, there's no doubt the bromide treatment of the coal to reduce emissions is definitely a more cost effective strategy with lower rate impacts. For example, at today's interest rates, the bromide coal strategy instead of \$46 million in construction loans reduces AEPCO's interest costs by \$1.2 million annually, for a total savings of \$30 million over the loan life.

Thanks for your interest and please give me a call if you'd like to discuss any of these items further.

Very truly yours,

GALLAGHER & KENNEDY, P.A.



By:

Michael M. Grant

MMG/plp

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cc: Alan Stephens (delivered)